

IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 1 of 1997

For Approval and Signature:

Hon'ble MR.JUSTICE R.K.ABICHANDANI and  
MR.JUSTICE KUNDAN SINGH

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1. Whether Reporters of Local Papers may be allowed to see the judgements?
2. To be referred to the Reporter or not?
3. Whether Their Lordships wish to see the fair copy of the judgement?
4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder?
5. Whether it is to be circulated to the Civil Judge?

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THE COMMISSIONER OF INCOME TAX

Versus

AMBALAL SARABHAI D. TRUST NO.5

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Appearance:

MR. B.B.NAYAK, Advocate with  
MR MANISH R BHATT for Petitioner  
MR RK PATEL with MR D.A.MEHTA, Advocates  
for Respondent

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CORAM : MR.JUSTICE R.K.ABICHANDANI and  
MR.JUSTICE KUNDAN SINGH

Date of decision: 26/02/98

ORAL JUDGEMENT (R.K.Abichandani,J.)

In this reference, the following two questions have arisen for the consideration of this court.

1. "Whether, the character of a discretionary trust can be changed by a resolution passed by the trustees?"
2. "Whether, the Appellate Tribunal has been right in law in holding that the Income Tax Officer was not justified in applying the rate of 65% under Section 164 of the Income Tax Act, 1961?"

Earlier, the application made by the Revenue under Section 256(2) of the Income Tax Act, 1961, seeking to call for the statement of case in respect of these two questions was rejected by a Division Bench of this Court against which the Revenue had preferred Civil Appeal No. 5194/96 before the Supreme Court of India and the Hon'ble Supreme Court, by order dated 21st March, 1996, had set aside that earlier order and directed this Court to examine the question in the light of the judgement of the Supreme Court in the case of Commissioner of Income Tax Vs. Kamalini Khatau, reported in 209 ITR 101. Accordingly, by order dated 27.11.1996 made on Income Tax Application No. 59/89, the Tribunal was directed to furnish statement of case in respect of the said two questions. When the matter came up for hearing before this Bench, it was noted that the Tribunal had allowed the appeals of the assessee following its earlier decision in Gira Sarabhai (G-12) D Trust for the Assessment Year 1977-78, but without disclosing the reasons that it adopted. The Tribunal was therefore, directed to forward the reasoned order on which it had placed reliance and accordingly, a further statement of case was forwarded to this Court.

2. The relevant Assessment Year is 1979-80. The assessee was a discretionary trust constituted under the Deed of Settlement dated 27.3.1961. Under the said trust deed, it was stipulated in clause 1(a) that the trustees shall to pay in the first instance, all costs, charges and expenses incidental to the administration of the trust funds out of the income of the trust funds, and during the period of 18 years from the date of the trust deed, they were authorised either to accumulate the net income of the trust funds or at their discretion, pay the same to the settlor's son Vikram and the settlor's daughters Bharati, Gira and Mrudula or the survivors or survivor of them or any one or more of them or to the exclusion of the others or other of them for their absolute use and benefit in such proportions and manner as the trustees may in their absolute discretion think fit. The net income of the trust funds that may not have been distributed by the trustees in any year, was

required at the end of the year to be added to and held as an accretion to capital and form part of the corpus of the trust funds. A resolution was passed by the trustees on 24th January, 1976, in exercise of their discretion under clause (1) of the trust deed, to the effect that the trustees shall pay the net income of the trust funds accruing or arising during the period from 1st April, 1976 upto and including 31st March, 2001 to one of the beneficiaries - namely Bharatidevi Sarabhai for her absolute use and benefit. In this background, the assessee trust filed a return of income showing income as 'nil' on 9th August, 1979. The stand taken by the assessee before the ITO was that the net surplus income of Rs. 29,583/- had been included in the total income of the beneficiary Smt. Bharatidevi Sarabhai and hence, total income of the assessee trust was shown as 'nil'. It was the assessee's case that such inclusion of income in the hands of the beneficiaries was made pursuant to the resolution passed on 24th January, 1976 and therefore, the income was required to be assessed in the hands of the beneficiary and that there should be no assessment under Section 164 of the Act. The ITO negatived this contention holding that the character of the trust remained as discretionary and therefore, the assessment was required to be made under Section 164 of the Act. Accordingly, total income of the assessee was computed at Rs. 28,980/- by applying the flat rate of 65%. In appeal, the Appellate Assistant Commissioner of Income Tax held that the ITO was justified in applying the rate of 65% under Section 164 of the Act, following his earlier order dated 5.3.1982 in the case of Gira Sarabhai (G-12) D Trust. The order of the Appellate Assistant Commissioner simply referred to reasons given in the earlier order without indicating those reasons. In the appeal which was carried to the Tribunal by the present assessee and other assessees of the same group, the Tribunal by it's order dated 28th March, 1985 followed similar practice of just referring to it's earlier order and allowed the appeal in the following terms:-

"The A.A.C has followed his order in the case of Gira Sarabhai (G-12) D. Trust for the Assessment Year 1977-78. This Tribunal, in the case of Gira Sarabhai (G-12) D. Trust for the Assessment Year 1977-78, has allowed the assessee's appeals. Therefore, consistently with that decision, these appeals are allowed."

Before we proceed to consider the questions which are referred to us, we are constrained to observe that

when the Tribunal decides an appeal by relying on it's earlier decision which contained reasons and chooses not to even indicate as to what those reasons were in its order, then that earlier decision which contained the reasons ought to be annexed with the decision of the Tribunal, so that when questions are required to be considered in a reference, the Court can have the benefit of the reasons which weighed with the Tribunal and to ascertain whether any error of law was committed. We expect that in future, in all such cases whenever the Tribunal decides any appeal merely on the basis of it's earlier decision, without indicating any reasons in it's order, then such earlier decision which contained reasons should invariably be annexed with the decision of the Tribunal while forwarding the statement of case to the High Court.

In further statement of case forwarded to this Court pursuant to the directions given, the order on which reliance was placed by the Tribunal has been forwarded. That order was made by the Tribunal in Saraladevi Sarabhai (B-11) D.Trust, Ahmedabad Vs. I.T.O on 26.4.1984. It appears from that decision that the Tribunal was concerned with a similar Trust and also with a resolution of the same date i.e. 24.1.1976,making identical provision in respect of one of the beneficiaries of that trust. It was contended before the Tribunal that Section 164 was not applicable to the appellant Trust. The relevant Assessment Year in that case was 1978-79. After referring to it's earlier decision, the Tribunal proceeded to consider notes on clauses regarding amendment which came to be made in the year 1980 by which Explanation (1) was inserted to Section 164 with effect from 1.4.1980 by the Finance (No.2) Act, 1980. Relying upon the observations made in para 49(iv) of the notes on clauses to the effect "Under the existing provisions, the flat rate of 65% is not applicable where the beneficiaries and their shares are known in the previous year, although such beneficiaries or their shares have not been specified in the relevant instrument of trust, order of the Court or wakf deed", the Tribunal held that the legislature had conceded thereby that Section 164(1) would not be applicable even in a case where the beneficiaries or their shares had not been specified in the trust deed and that the meaning of the Section was not clear without the explanation. It was held that when two interpretations were possible, one in favour of the assessee was required to be taken, and therefore, Section 164(1) was not applicable to the assessee's case. This is the reasoning which was followed, by reference, by the Tribunal for its order

dated 26.4.1984 in appeals of an assessee of the same group and that later nonspeaking order was relied upon while allowing the appeal of the present assessee trust "consistently with that decision".

3. The learned Counsel appearing for the Revenue contended before us that the provisions of Section 164 of the Act were attracted in this case because the trust was a discretionary trust as reflected from the trust deed and the shares of the beneficiaries were indeterminate or unknown. It was submitted that mere passing of a resolution by the trustees to give income for a particular year to one of the beneficiaries will not change the nature of the trust which would nonetheless remain a discretionary trust and therefore, the income will have to be assessed in the hands of the trust notwithstanding the payments made to one beneficiary. It was further submitted that Explanation (1) (ii) though enacted with effect from 1.4.1980, was only clarificatory in nature and applied to pending cases. It was submitted that even without resorting to that explanation on the plain reading of Section 164 as it stood at the relevant time, it was open for the ITO to assess the trust because the shares could not be said to have been become determinate merely on a decision of the trustees to make payment of income to one of such beneficiaries. Reliance was placed on a decision of the Hon'ble Supreme Court in CIT Vs. Kamalini Khatau, reported in 209 ITR 101 in support of the submission that the Revenue had an option to assess and recover tax either from the discretionary trust or from the beneficiaries. Reliance was also placed on some observations made in a decision of this Court in CIT Vs. Gosar Family Trust, reported in 189 ITR 18 to the effect that it could not be the intention of the legislature to leave it to the sweet-will of the trustees to subject the income to the maximum marginal limit or not simply by virtue of their decision to distribute the income amongst the beneficiaries.

The learned Counsel appearing for the assessee trust contended that the decision of the Supreme Court in Kamalini Khatau (*supra*) was given in context of the provisions of Section 164 as they stood in respect of the relevant assessment year of 1969-70. It was submitted that the relevant provision (which is reproduced on page 107 of the report), contained two requirements namely that the income was not specifically receivable on behalf of or for the benefit of any one person, or where the individual shares of the persons, on whose behalf or for whose benefit such income or part thereof was receivable, were indeterminate or unknown. It was submitted that it

is only when these two requirements were satisfied, that the provisions of Section 164 could be invoked for assessing the Trust. The contention was that this basic requirement had remained the same even in the subsequent amendmented provision. It was pointed out that under the provision of Section 164 with which the Supreme Court was concerned in Kamalini Khatau (*supra*), the income of such representative assessee was required to be assessed as if it was the total income of an AOP, or where such income was actually received by the beneficiary, then at the rate or rates applicable to the total income or total world income of the beneficiary, if such course would result in a benefit to the Revenue. It was submitted that as soon as trustees resolved to pay net income arising from the trust funds to only one beneficiary, the two basic requirements which otherwise would have attracted the provision of Section 164(1) ceased to exist. It was further submitted that a representative assessee is to be assessed only for the beneficial interest and once payment is made to the beneficiary, there would remain no beneficial interest in the hands of the representative assessee, which could be taxed. Reliance was placed by the learned Counsel in support of his submissions on a decision of the Supreme Court in CWT Vs. Trustees of H.E.H Nizam's Family, reported in 108 ITR 555, which was rendered in the context of a similar provision contained in Section 21 of the Wealth Tax Act. It was pointed out that the Supreme Court had held therein that so long as it is possible to say on the relevant valuation date that the beneficiaries are known and their shares are determined, the possibility that the beneficiaries may change, would not take the case out of the ambit of the provisions of Section 21(1). It was submitted that even in the present case it was possible to say with certainty that at the end of the relevant previous year there was only one beneficiary who was required to be paid, the entire income.

The learned Counsel further argued that Explanation (1) could never be construed as a retrospective provision, pointing out from the Amendment Act and the explanatory notes, objections, reasons etc. that they indicated that the new provision was required to be followed from 1.4.1980 onwards. It was submitted that the said provision was not merely a procedural provision, because, after the insertion of this explanation, the Assessing Officer was not required to undergo the exercise of ascertaining whether at the end of the previous year, the shares of beneficiaries had become determinate or not. It was submitted that the said explanation had done away with the concept of the

relevant date and such a provision cannot be construed as having a retrospective effect. The sum and substance of his contention was that shares cannot be said to have remained indeterminate or unknown when by resolution the trustees had decided to give the entire net income to one beneficiary.

4. Admittedly, the assessee trust was formed as a discretionary trust under the deed of settlement executed on 27.3.1961. Clause (1)(a) which is referred to hereinabove authorised the trustees to pay in the first instance all costs, charges and expenses incidental to the administration of the trust funds out of the income of the trust funds. The trustees were further authorised to either accumulate the net income of the trust funds or at their discretion pay the same to the beneficiaries named therein or any one or more of them to the exclusion of others. The shares of these beneficiaries were not at all indicated and it was specifically left to the absolute discretion of the trustees to decide upon the proportions in which the amount may be paid by them. It is clear from the provisions of the trust deed that the shares of the beneficiaries were indeterminate and unknown. The word indeterminate would mean not fixed in extent or character. The shares of the beneficiaries were clearly not fixed either in extent or character in the said writing executed for creating the trust.

5. The provision of Section 164(1) to the extent it is relevant for the purpose of this reference and as it stood at the relevant time reads as under:-

"164. Charge of tax where share of beneficiaries unknown:-

(1) Subject to the provisions of sub-sections

(2) and (3), where any income in respect of which the persons mentioned in clauses (iii) and (iv) of sub-section (10 of Section 160 are liable as representative assessees or any part thereof is not specifically receivable on behalf or for the benefit of any one person or where the individual shares of the persons on whose behalf or for whose benefit such income or such part thereof is receivable are indeterminate or unknown (such income, such part of the income and such persons being hereafter in this Section referred to as "relevant income", "part of relevant income" and "beneficiaries", respectively), tax shall be charged -

(i) as if the relevant income or part of relevant income were the total income of an association of persons, or

(ii) at the rate of sixty-five per cent,

whichever course would be more beneficial to the Revenue:"

The above provision applies to all representative assessee mentioned in clauses (iii) and (iv) of Section 160(1) of the Act if the income for which they were liable as representative assessee, was not receivable on behalf of or for benefit of any one person or where individual shares of beneficiaries were indeterminate or unknown. Therefore, if there was only one beneficiary of the income or where the shares of beneficiaries in that income were known or determinate, the provision of Section 164 did not apply. If the trust deed did not define the individual shares of the beneficiaries, the provisions of Section 164 would get attracted. In the case of a discretionary trust, where it is entirely left to the discretion of the trustees to distribute among the beneficiaries the net income of the trust in such proportions as it pleases them, the shares of the beneficiaries would be indeterminate. The representative assessee falling in clause (iv) of Section 160(1) who is entitled to receive income on behalf of or for the benefit of any person, is liable under Section 161(1) to be assessed in his own name, as regards the income in respect of which he is a representative assessee as if the income were income accruing to him. It would therefore follow that merely because a trustee who is liable to be assessed as a representative assessee has a discretion to distribute the income to any one of the beneficiaries, his liability to be assessed as a representative assessee does not vanish on his paying the net income to a particular beneficiary. It is because the shares are not fixed i.e. they are indeterminate or unknown that the trustees become enabled to exercise discretion to distribute the income to one or more of the beneficiaries in any portion they like. Therefore, merely because they are in a position to disburse the trust income to any one of the beneficiaries, that cannot mean that they are doing so because the shares are determinate or known. The real question is whether the representative assessee i.e. the trustees could themselves have known the shares of the beneficiaries at the time when they received the income during the previous year. The knowledge whether the shares are fixed could be derived by them only from the contents of

the trust-deed. If the shares are not fixed in the instrument under which the trust is created, so far as the trustees are concerned, the shares of the beneficiaries would be indeterminate or unknown and that is why as per the discretion given to them they would be in a position to allot any portion of income to any one of the beneficiaries or to more than one. In other words, from the factum of distribution or disbursement of the trust income or deciding upon the portions in which it is to be given to any of the beneficiaries, it can never be inferred that their shares were already fixed or determinate.

6. When the entire income accruing to the trustees is not passed on to the beneficiaries but administrative charges and expenses are paid out of the trust's income, the entire trust income would be assessable in the hands of the trust as a representative assessee and not merely the net income which reaches the beneficiary, just as the entire income would have been assessed in the hands of the beneficiary if he had been in direct receipt of such income. As held by the Supreme Court in Mrs Arundhati Balkrishna Vs. CIT, reported in 177 ITR 275, the Income Tax Officer has an option to proceed either against the trustees or against the beneficiary, but in either case, the income to be assessed must be in the same sum. What the trustee receives as the income pertaining to the beneficiary is received by him under an obligation towards the beneficial interest. In most cases, administration charges and expenses have to be met out of the trust's income and it is only the net income which reaches the beneficiary. As noted above from the resolution passed by the trust, it was the net income which was to be paid to one beneficiary named in the resolution, which would be disbursement of the amount that remained after deducting the expenses from the entire income that had accrued to the trust. This payment, in our view, was made by the trustees in their discretion given to them under the trust deed, since the shares of the beneficiaries were indeterminate. The decision to disburse the amount of net income to the beneficiary named in the resolution was taken not because her share was already fixed, but because the shares of the beneficiaries were not fixed and it was left to the trustees to disburse the income the way they liked. In our view, the disbursement of income to any one of the beneficiaries by the trustees of a discretionary trust in exercise of their discretion, cannot imply that the shares of the beneficiaries were fixed or that they ceased to be indeterminate or unknown. The provisions of Section 164(1) were therefore, clearly attracted in the

case of the assessee trust.

7. In CWT Vs. Trustees of Nizam's Family Trust (supra) on which reliance was placed on behalf of the assessee, it was on the basis of the trust deed that the Court had come to the conclusion that the shares could be determined. The Andhra Pradesh High Court, whose decision was confirmed by the Supreme Court at page 572 of the report had observed:- "There can be no doubt that under the terms of the deed of trust such persons and their shares could be so determined. The "trust-heirs" if one may use such an expression to describe the persons entitled ultimately, - given date and their shares are mere a matter of arithmetic. That would be sufficient to exclude the application of Section 21(4) of the Act". The Supreme Court also at page 600 of the report observed: "Now, in the present case it is clear from the provisions of the trust deed that, in the case of each set of unit or units, it is possible to say with certainty and definiteness on each relevant valuation date as to who would be the beneficiaries and in what specific shares, if the respective relative mentioned in the second schedule to whom such set of unit or units is allocated under the trust deed were to die on that date". The Supreme Court approvingly referred to the propositions formulated by the Bombay High Court in Trustees of Putlibhai R.F. Mulla Trust Vs. Commissioner of Wealth Tax, reported in 66 ITR 653, wherein it was held : "Therefore, whatever may be the position as to any future date so far as the relevant date in each year is concerned, it is upon the terms of the trust deed always possible to determine who are the sharers and what their shares respectively are."

In the present case, as noted above, the trust deed creating the discretionary trust scrupulously avoided fixing of the shares of the beneficiaries and left it entirely to the trustees to determine the proportions in which they may be given the net income as also whether to give it at all. Therefore, the decision of the Supreme Court in CWT Vs. Trustees of Nizam's Family Trust (supra) cannot assist the assessee in the present case.

8. It would be noted that we have reached above conclusion without any reference whatsoever to the explanation which was introduced in Section 164(1) from 1.4.1980. The Tribunal instead of construing the provision as it applied at the relevant time, unnecessarily resorted to an unwarranted reasoning by referring to the so-called concession by the legislation

in notes of clauses reflected from Clause 49(iv) referred to by the Tribunal in its earlier reasoned order which it followed, and reached a conclusion which, as seen above, flies in the face of the statutory provision. The contention that because the net income was distributed by the trustees of a discretionary trust, the provisions of Section 164 should not be applied even though the shares were indeterminate in trust deed, if accepted, would make the provision redundant. Even the pre-amended provision of Section 164 (which fell for consideration of Hon'ble the Supreme Court in Kamalini Khatau's case), under which the Assessing Officer was required to charge tax on the income of such representative assessee as if it was total income of an association of persons or where such income was received by a beneficiary, then at the rate applicable to the total income or total world income of the beneficiary, if such course was more beneficial to the revenue, did not thereby provide that where the beneficiary had received the income the representative assessee could not be taxed. Reference to the situation where the amount was received by the beneficiary was only with a view to apply a higher rate of tax wherever applicable in such cases, while assessing the income in the hands of the representative assessee. In Kamalini Khatau's case (*supra*) the beneficiary had objected to her assessment contending that the discretionary trust should be assessed. It is in context of such contention that the Court held that where the income of a discretionary trust is within the accounting year distributed to and received by the beneficiary, that would be subject to assessment in his hands and tax thereon would be recoverable from him. The Court negatived the contention of the assessee that Section 164 should be read as a code in itself and observed: "it cannot be held that the beneficiary of a discretionary trust, even if he has received its income in the accounting year, cannot be taxed thereon because Section 164 does not provide for such contingency". The Supreme Court in terms held that the liability of a trustee of a discretionary trust to be assessed to tax in respect of its income and recovery thereof is created by Section 161, while Section 164 sets out only how such tax shall be charged when the income is not distributed and when the income is distributed. Therefore, merely from the factum of distribution of income by the discretionary trustees, it cannot be inferred that the shares were not indeterminate. The provisions of Section 164 as they stood in the relevant year which was under consideration in Kamalini Khatau's case, in fact contemplated actual receipt of income by the beneficiary in which event if a higher rate was attracted if the income were to be assessed in the hands

of the beneficiary, then such higher rate was to be adopted while assessing the income in the hands of the representative assessee. Even in C.R. Nagappa Vs. CIT, reported in 73 ITR 626, which the Supreme Court followed in Kamalini Khatau's case, it was held that it was implicit in terms of Section 161(1) that the Income Tax Officer could assess a representative assessee as regards the income in respect of which he was a representative assessee, but he was not bound to do so. He could assess either the representative assessee or the person represented by him. The Revenue therefore, had the option to assess and recover tax from either the trust as the representative assessee or from the beneficiaries of a discretionary trust in respect of such income thereof as has been distributed and received by the beneficiaries in the course of the accounting year as held by Hon'ble the Supreme Court in Kamalini Khatau's case. This decision of the Supreme Court clearly negatives the contention that the assessment could not have been made in the hands of the representative assessee. The Supreme Court gave this decision in context of a similar discretionary trusts in respect of the other members of the group of the present assessee. The mere fact that the later part of the provision of Section 164(1), as it applied in that case at the relevant time, enabled the Assessing Officer to resort to the rate applicable to the total income or total world income of the beneficiary in cases where the income was actually received by the beneficiary if such a course was more beneficial than applying the rate applicable to the total income of an AOP, does not make the ratio of the Supreme court inapplicable to the present case. The latter part of Section 164(1) came to be substituted by a flat rate of 65% which was to be made applicable if it was more beneficial than applying the rate that would apply to the total income of an AOP.

Thus, in our opinion, the Tribunal has committed an error in holding that the Income Tax Officer was not justified in applying the rate of 65% under Section 164 of the Income Tax Act, 1961. Question No.2, which is the substantive question, is therefore, answered in the negative in favour of the Revenue and against the assessee. The question No.1 is as to whether the character of a discretionary trust can be changed by the resolution passed by the trustees. In context of the facts found above, we hold that the representative assessee continued to be a discretionary trust despite the resolution passed by the trustees for distribution of the net income of the trust to one of the beneficiaries. Question No.1 is answered accordingly. The reference

stands disposed of accordingly with no order as to costs.

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\* /Mohandas